State Profile

Spring 2005

Hawaii

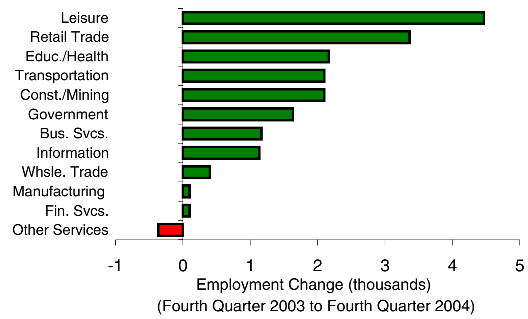
Hawaii year-over-year job growth improved in fourth quarter 2004 to 3.2 percent (fifth fastest growth in the nation) and is expected to stay relatively strong in 2005.

- The Hawaii tourism sector ended a banner year in fourth quarter 2004, reporting strong visitor volumes, tourist spending, and hotel revenues. Also, the leisure, retail trade, and transportation sectors reported solid job growth. Together, these three sectors added more than 10,000 jobs during the year, accounting for over half of all new positions in the state (See Chart 1).
- Hawaii's government sector also reported strong gains in employment, adding about 1,600 positions. The state government education subsector accounted for most of the new jobs in 2004. Going forward, planned improvements to the state's transportation infrastructure will likely mean continued strength in the sector.
- Overall, the weaker U.S. dollar boosted international tourism and spending in Hawaii, but risks remain as Japan reported continued economic weakness. This could weigh on the state's tourism sector as 15 percent of visitors are from Japan.

Home price gains were robust, but may face risks.

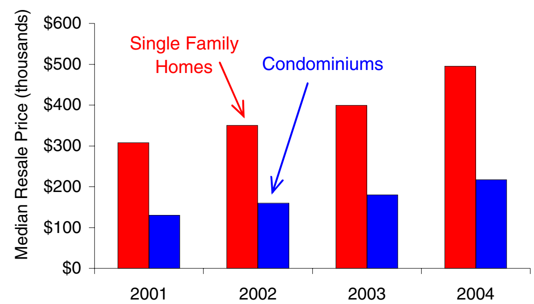
- Hawaii ended 2004 with strong sales volume and prices for both single family homes and condominiums. During 2004, Honolulu single family home and condominium prices climbed 24 percent and 21 percent, respectively (See Chart 2).
- **Honolulu** realtors reported that unsold inventory tightened to 2.6 months for houses and 2.1 months for condominiums in February 2005 after rising in the latter part of 2004.[1] While low inventories could maintain pricing pressures in the near term, rising interest rates, low affordability, and continued additions to the housing stock may constrain longer-term home price trends.
- A shift in the nature of insured institution exposures to housing markets may elevate banking risks. Strong growth of home equity lines of credit (HELOCs) and construction and development (C&D) loans pushed the median

Chart 1: Most Major Sectors of the Hawaii Economy Added Jobs in 2004



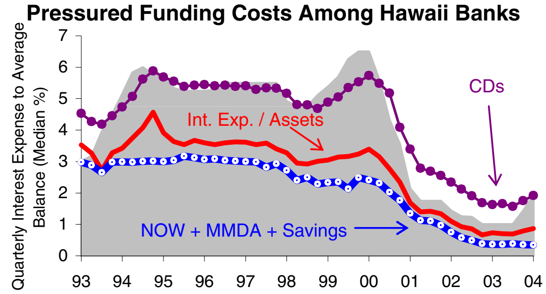
Source: Bureau of Labor Statistics

Chart 2: Hawaii Housing Prices Continued to Rise



Source: Honolulu Board of Realtors (data from December of each year)

Chart 3: Rate Hikes in the Second Half of 2004 Pressured Funding Costs Among Hawaii Banks



Note: Includes Call Report filers only. NOW is negotiable order of withdrawal; MMDA is money market deposit account; CD is certificate of deposit. Gray shaded area denotes average target Federal Funds rate for the quarter.
Sources: FDIC; Federal Reserve

[1] Honolulu Board of Realtors, February Residential Resales Statistics, March 2, 2005 (http://www.hicentral.com/stat-pr.asp).

HELOC-to-Tier 1 capital ratio to an above-average 36 percent and the median C&D loan-to-Tier 1 capital ratio to 37 percent. Low interest rates and improving economic conditions, however, likely contributed to a drop in the median past-due 1-4 family loan ratio to a very low 0.42 percent.

Honolulu office real estate vacancies expected to rise.

- Consistent with slower job growth in office-occupying sectors such as business services and information, absorption of new office space in Honolulu is expected to lag construction of new properties over the next two to five years. Torto Wheaton Research (TWR) expects the market's vacancy rate to rise from a year-end 2004 rate of 12.5 percent to 13.2 percent by the end of 2006. While the vacancy rate likely will remain below the average of major markets nationwide, TWR's forecast of rising vacancies is notable given that nearly two-thirds of all major markets are expected to see improved conditions.

- Rising vacancies could pressure asset quality among insured institutions, which reported a median concentration of commercial real estate (CRE) loans to Tier 1 capital of 224 percent.[2] Currently, CRE loan performance is strong, and institutions reported a low and declining past-due rate of 0.08 percent at year-end 2004.

Funding costs increased in late 2004 but remained among the lowest in the nation.

- Hawaii-based banks reported a median quarterly interest expense-to-average asset ratio of 0.87 percent in fourth quarter 2004, up from prior quarters, but well below a nationwide median of 1.43 percent (See Chart 3). Banks headquartered in the state reported among the lowest funding costs of any state for several deposit categories. Interest expense ratios benefited from high exposures to low-cost checking and savings accounts, which increased to 45 percent of total assets on a median basis, the second highest ratio in the nation.

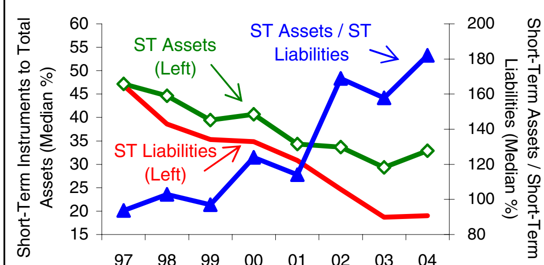
- Lengthening funding structures may soften the effects of rising interest rates on overall interest expense burdens. The proportion of assets funded by certificates of deposit and other borrowings maturing in less than one year declined from 47 percent in 1997 to 19 percent in 2004, in part a reflection of the smaller number of finance companies in the state, which typically depended heavily on short-term funding.[3]

Credit quality improved but earnings moderated.

- The median pre-tax return on assets among Hawaii-based insured institutions fell from 2.32 percent at year-end 2003 to 1.96 percent in 2004. Improving asset quality enabled insured institutions to reduce additions to loan loss reserves. However, narrower net interest margins (NIMs), weaker fee income ratios, lower securities gains, and higher overhead expense ratios more than offset the provision expense savings. High and increasing tax expense-to-average asset ratios (reflecting tax settlements at some institutions) weighed on after-tax returns.

- Despite year-to-date trends, NIMs strengthened on a quarterly basis in the second half of the year, as rising asset yields outpaced liability costs. In part because of the decline in Hawaii finance companies, the repricing interval of assets and liabilities among Hawaii-based banks shifted recently and may benefit margins as interest rates increase (See Chart 4). However, heavy reliance on longer-term loans, mortgage-backed securities, and rate-sensitive time deposits by some mortgage lenders may pressure earnings at those institutions as rates increase. Higher rates could also dampen the value of securities and available gains, which were important components of balance sheets and profits in recent years.

Chart 4: Short-Term Liability Dependence Has Declined Faster than Short-Term Asset Reliance



Note: Includes Call Report filers only. Short-term (ST) assets and liabilities include instruments with contractual maturity or repricing in the next 12 months and excludes non-passthrough mortgage-backed securities and non-maturity deposits.
Source: FDIC (December of each year)

[2]CRE loans include construction, multifamily, and nonfarm-nonresidential mortgages.
[3]Data from 1997 included 14 banks, 7 of which were small finance companies that have since merged with other entities or ceased operations.

Hawaii at a Glance

ECONOMIC INDICATORS (Change from year ago quarter, unless noted)

Employment Growth Rates	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Total Nonfarm (share of trailing four quarter employment in parentheses)	3.2%	1.6%	2.7%	-1.7%	3.1%
Manufacturing (3%)	0.6%	2.9%	-6.5%	-4.2%	3.1%
Other (non-manufacturing) Goods-Producing (5%)	7.4%	5.2%	10.0%	-4.3%	10.8%
Private Service-Producing (72%)	3.6%	1.7%	2.8%	-2.4%	3.2%
Government (21%)	1.4%	0.2%	2.1%	1.7%	1.3%
Unemployment Rate (% of labor force)	3.1	3.8	3.7	5.1	3.8

Other Indicators	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Personal Income	N/A	5.4%	5.3%	0.9%	5.4%
Single-Family Home Permits	-8.9%	7.0%	43.3%	-14.8%	26.5%
Multifamily Building Permits	842.0%	-77.6%	152.4%	25.4%	-44.7%
Existing Home Sales	3.9%	22.8%	31.8%	0.0%	22.2%
Home Price Index	24.6%	14.7%	8.3%	8.2%	6.1%
Bankruptcy Filings per 1000 people (quarterly level)	0.59	0.69	0.79	0.97	0.92

BANKING TRENDS

General Information	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Institutions (#)	8	8	9	10	10
Total Assets (in millions)	33,843	31,928	30,396	29,989	30,861
New Institutions (# < 3 years)	0	0	0	0	0
Subchapter S Institutions	0	0	0	0	0

Asset Quality	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Past-Due and Nonaccrual Loans / Total Loans (median %)	0.56	0.86	1.50	1.95	2.07
ALLL/Total Loans (median %)	1.62	1.86	1.87	1.71	1.68
ALLL/Noncurrent Loans (median multiple)	6.29	4.65	2.42	1.65	1.09
Net Loan Losses / Total Loans (median %)	0.05	0.08	0.08	0.22	0.61

Capital / Earnings	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Tier 1 Leverage (median %)	7.46	8.21	8.71	8.31	8.47
Return on Assets (median %)	1.28	1.48	1.00	0.68	0.86
Pretax Return on Assets (median %)	1.96	2.32	1.51	0.98	1.30
Net Interest Margin (median %)	4.35	4.50	4.30	4.07	4.52
Yield on Earning Assets (median %)	5.27	5.51	6.26	7.40	8.15
Cost of Funding Earning Assets (median %)	1.14	1.24	1.69	3.31	3.84
Provisions to Avg. Assets (median %)	0.00	0.04	0.08	0.19	0.41
Noninterest Income to Avg. Assets (median %)	0.94	1.01	0.94	0.67	0.67
Overhead to Avg. Assets (median %)	3.04	2.82	2.72	2.85	2.94

Liquidity / Sensitivity	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Loans to Assets (median %)	56.4	62.7	56.4	57.9	67.8
Noncore Funding to Assets (median %)	28.6	22.1	26.5	32.0	33.4
Long-term Assets to Assets (median %, call filers)	21.6	27.6	17.1	14.3	22.1
Brokered Deposits (number of institutions)	3	3	0	0	3
Brokered Deposits to Assets (median % for those above)	0.1	0.1	0.0	0.0	0.2

Loan Concentrations (median % of Tier 1 Capital)	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Commercial and Industrial	110.8	116.0	89.3	78.1	102.3
Commercial Real Estate	224.0	195.5	126.9	111.7	110.1
Construction & Development	36.6	26.0	28.4	16.0	15.0
Multifamily Residential Real Estate	8.2	9.4	7.7	8.8	8.8
Nonresidential Real Estate	118.7	116.9	74.4	63.0	74.4
Residential Real Estate	223.0	293.0	293.9	307.1	310.4
Consumer	33.6	31.0	30.9	34.6	31.9
Agriculture	1.3	1.8	1.6	0.9	0.9

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits ($ millions)
Honolulu, HI	10	18,402

Asset Distribution	Institutions
< $250 mil.	0 (0%)
$250 mil. to $1 bil.	2 (25%)
$1 bil. to $10 bil.	5 (62.5%)
> $10 bil.	1 (12.5%)